



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

REPORT OF THE AUDITOR-GENERAL TO NORTH WEST PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MADIBENG LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Madibeng Local Municipality, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information as set out on pages xx to xx.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment of R1 598 080 209 (2011: R1 409 835 640) disclosed in note 3 to the financial statements due to significant shortcomings in the asset register and differences between financial statements and asset register. I was unable to confirm the existence, completeness, valuation and rights of property, plant and equipment by alternative means. Consequently I was unable to determine whether any adjustment relating to property, plant and equipment in the financial statements was necessary.
5. SA Standards of GRAP, GRAP 17, *Property, Plant and Equipment* require that the useful life and residual value of an asset shall be reviewed at least at each reporting date. Contrary to this requirement the municipality did not perform a reassessment of useful lives and residual values. I was unable to perform alternative procedures. Consequently, I was unable to satisfy myself as to the valuation of assets of R1 598 080 209 (2011: R1 409 835 640) as disclosed in note 3 to the financial statements or the accuracy, occurrence, completeness, classification and cut-off of the depreciation expense of R37 825 405 (2011: R 37 843 086) as per the statement of financial performance.



Investment property

6. I was unable to obtain sufficient appropriate audit evidence to verify completeness, rights and obligations, valuation and allocation of investment property of R91 249 000 disclosed in note 2 to the financial statements. I was unable to confirm the existence, completeness, rights, valuation and allocation of investment property by alternative means. Consequently I was unable to determine whether any adjustment relating to investment property in the financial statements was necessary.

Consumer debtors

7. SA Standard of GRAP, IAS 39, *Financial Instruments: Recognition and Measurement*, paragraph 58 requires that an entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. The municipality did not assess consumer debtors, individually or by category, for any indication that these assets may be impaired. The municipality's system did not allow the performance of alternative audit procedures to practicably determine the extent of the misstatement in debtors and the impairment expense. Consequently I am unable to satisfy myself as to the valuation and allocation of consumer debtors of R234 858 579 (2011: R210 415 580) as disclosed in note 10 to the financial statements or the impairment expense of R140 447 949 (2011: R112 964 373) as per the statement of financial performance.

Other receivables

5. I was unable to obtain sufficient appropriate audit evidence to verify the existence, completeness, valuation and rights for other receivables of R12 226 794 (2011: R12 329 185) as disclosed in note 6 to the financial statements. I was unable to confirm the existence, completeness, rights and obligations, valuation and allocation of other receivables by alternative means. Consequently I was unable to determine whether any adjustment relating to other receivables in the financial statements was necessary.

Trade and other payables

6. I was unable to obtain sufficient appropriate audit evidence for trade and other payables of R232 907 269 (2011: R268 125 751) as disclosed in to note 16 to the financial statements. I was unable to confirm the existence, completeness, obligations, valuation and allocation of trade and other payable by alternative means. Consequently I was unable to determine whether any adjustment relating to trade and other payables in the financial statements was necessary.

Consumer deposits

7. I was unable to obtain sufficient appropriate audit evidence to verify the completeness of consumer deposits of R12 887 265 as disclosed in note 18 to the financial statements. I was unable to confirm the completeness of consumer deposits by alternative means. Consequently I was unable to determine whether any adjustments relating to consumer deposits in the financial statements were necessary.

Revenue

8. As reported in the prior year, my opinion on the corresponding figure for revenue from electricity and sale of water was modified. The municipality failed to make proper adjustments to the corresponding figure reported. Consequently, the occurrence, accuracy, completeness, classification and cut-off of the corresponding figures of R257 246 010 and R42 663 884 disclosed in note 20 to the financial statements could not be confirmed.
9. I was unable to obtain sufficient appropriate evidence for other income, agency fees, licence and permits, fines and rental of facilities and equipments amounting to R34 209 096 as

disclosed in the statement of financial performance and note 22 to the financial statements. I was unable to confirm the occurrence, completeness, accuracy, classification and cut-off by alternative means. Consequently, I was unable to determine whether any adjustment relating to other revenue in the financial statements was necessary.

Expenditure

10. I was unable to obtain sufficient appropriate audit evidence for bulk purchases of R317 871 122 (2011: R287 304 373) and contracted services and general expenses of R138 707 363 (2011: R130 479 633) as per the statement of financial performance. I was unable to confirm the occurrence, accuracy and completeness of this expenditure by alternative means. Consequently I was unable to determine whether any adjustment relating to this expenditure in the financial statements was necessary.

Capital commitments

11. I was unable to obtain sufficient appropriate audit evidence to verify the commitment amount of R96 518 597(2011: R0), disclosed in note 35 to the financial statements. I was unable to confirm occurrence; obligations; completeness; classification; accuracy and valuation of commitments by alternative means. Consequently, I was unable to determine whether any adjustments to commitments in the financial statements were necessary.

Cash flow statement

12. The municipality did not classify outflows from repayment of other financial liabilities in accordance with GRAP 2, *Cash Flow Statements*. The municipality classified repayment of financial liabilities as inflows instead of outflows in the cash flow statement. Consequently, cash inflows and cash and cash equivalents are overstated by R95 571 954.

Cash and cash equivalents

13. I was unable to obtain sufficient appropriate audit evidence to verify existence, valuation and right and obligations of cash and cash equivalents of R39 368 849 as disclosed in note 11 to the financial statements. I was unable to confirm the existence, rights and obligations, valuation and allocation of cash and cash equivalents by alternative means. Consequently I was unable to determine whether any adjustment relating to cash and cash equivalents in the financial statements was necessary.

Contingent liabilities

14. SA Standards of GRAP, GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets* requires the municipality to disclose any events not wholly in the control of the municipality and that give rise to the possibility of an outflow of economic benefits. The municipality did not disclose contingent liabilities amounting to R13 849 166. Consequently, contingent liabilities disclosed in note 36 to the financial statements are understated.

Irregular expenditure

15. Section 125(2)(d)(i) of the MFMA requires disclosure of all material irregular expenditure. I was unable to obtain sufficient appropriate audit evidence for awards of R 17 579 725 (2011: R424 621 756) made in terms of the municipality's supply chain management policy. In addition, irregular expenditure incurred of R 71 342 777 due to payments made in contravention with the municipality's supply chain management policy was not disclosed in note 42 of the financial statements. Consequently, I was unable to determine the understatement of irregular expenditure.
16. The municipality disclosed irregular expenditure amounting to R 8 277 931 for the current



financial period as per note 42 of the financial statements. The irregular expenditure disclosed does not meet the definition of irregular expenditure as per *Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003)*. As a result irregular expenditure disclosed in note 42 of the financial statements is overstated by R 8 277 931.

Unauthorised expenditure

17. The municipality disclosed unauthorised expenditure amounting to R 18 287 459 for the current financial period as per note 40 of the financial statements. The unauthorised expenditure disclosed does not meet the definition of unauthorised expenditure as per *Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003)*. As a result unauthorised expenditure disclosed in note 40 of the financial statements is overstated by R 18 287 459.

Prior period errors

18. I was unable to obtain sufficient appropriate audit evidence to determine that all requirements of SA Standards of GRAP, GRAP 3, *Accounting policies, changes in accounting estimates and errors* was adhered as disclosed in note 37 to the financial statements. The municipality's system did not allow the performance of alternate audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the presentation and disclosure of the prior year errors. I was unable to determine the effect of this limitation on the other account balances and classes of transactions contained in the financial statements.

Accumulated surplus

19. Limitations placed on my audit relating to expenditure, revenue transactions and adjustments made to the accumulated surplus in prior years have not been resolved. In the absence of sufficient appropriate audit evidence to substantiate these transactions and adjustments included in accumulated surplus stated of R1 112 890 523 (2011: R934 564 255), I was unable to verify the completeness, valuation and allocation by alternative means. Consequently I was unable to determine whether any adjustment relating to accumulated surplus in the financial statements was necessary.

GRAP disclosures

20. The municipality did not disclose in the financial statements new SA Standards of GRAP that have been issued, that are not yet effective and that were not applied as required by SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. This fact and the known or reasonably estimable information relevant to assessing the possible impact that application of the new Standard will have on the entity's financial statements in the period of initial application, was not disclosed in the financial statements.

Material losses

21. The municipality did not include particulars of material losses in the notes to the financial statements as required by section 125(2)(d)(i) of the MFMA. I have not determined the correct amount of distribution losses as it was impracticable to do so

Disclaimer of opinion

22. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters



23. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Significant uncertainties

24. As disclosed in note 35 to the financial statements, the municipality is the defendant in a number of civil claims. The municipality is opposing these claims as it believes it has got a realistic chance of winning them. The ultimate outcome of these matters cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

25. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an error discovered during 2012 in the financial statements of the Madibeng Local Municipality at, and for the year ended, 30 June 2011.

Material losses

26. As disclosed in note 26 to the financial statements, material losses to the amount of R140 447 948 were incurred as a result of provision for debt impairment on irrecoverable trade debtors.

Material under spending of the budget

27. As disclosed in note 21 of financial statement, the municipality has materially under spent the budget on the Municipal Infrastructure Grant by R 70 028 412. As a consequence, the municipality has not achieved its objectives of providing access to basic services, maximizing job creation and skill development, uplifting the life of the communities and poverty alleviation.

Additional matter

28. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary schedules

29. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these annexures and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

30. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

31. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages XX to XX of the annual report.

32. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury Framework for managing programme performance



information (FMPPi).

33. The reliability of the information in respect of the selected programmes / objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
34. The material findings are as follows: concerning the usefulness and reliability of the information.

Usefulness of information

35. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 35% of the reported indicators and 53% of objectives are not consistent with the indicators and objectives as per the approved integrated development plan. This is due to the lack of adequate performance management systems.
36. The National Treasury FMPPi requires that performance indicators be well defined and verifiable and targets be specific, measureable and time bound:
 - A total of 75% of the indicators relevant to the basic municipal services and municipal infrastructure were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently.
 - A total of 75% of the indicators relevant to the basic municipal services and municipal infrastructure were not verifiable in that valid processes and systems that produce the information on actual performance did not exist.
 - A total of 53% of the targets relevant to the basic municipal services and municipal infrastructure were not specific in clearly identifying the nature and the required level of performance.
 - The required performance could not be measured for a total of 53% of the targets relevant to basic municipal services and municipal infrastructure.

This was due to the fact management was aware of the requirements of the FMPPi but did not receive the necessary training to enable application of the principles.

Reliability of information

37. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. A total of 25% and 45% of the actual reported indicators relevant to basic services and municipal infrastructure were not accurate when compared to source information. This was due to a lack of monitoring procedures for the recording of actual achievements by senior management.
38. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of the actual reported performance relevant to 50% and 40% of basic service. This was due to the institution's records not permitting the application of alternative audit procedures.

Additional matter

39. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

40. Of the total number of 187 planned targets, only 132 targets were achieved during the year



under review. This represents 29% of total planned targets that were not achieved during the year under review. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process.

Compliance with laws and regulations

41. I performed procedures to obtain evidence that the Municipality has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Budget

42. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statement and performance report

43. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimer audit opinion.
44. The annual performance report for the year under review does not include a comparison with the performance of previous financial year as required by section 46(1) (b) of the MSA.

Expenditure Management

45. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
46. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
47. Irregular expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.
48. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred as required by section 65(2)(b) of the MFMA.

Revenue management

49. An adequate management, accounting and information system was not in place which accounted for debtors and receipts of revenue, as required by section 64(2)(e) of the Municipal Finance Management Act.

Asset management

50. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.
51. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c).

Liability management

52. An effective system of internal control for liabilities was not in place, as required by section 96(2)(b) of the MFMA.
53. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 96(2)(a) of the Municipal Finance Management Act.



Procurement and contract management

54. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) & (c).
55. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
56. Awards were made to suppliers based on preference points that were not allocated and/or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
57. Awards were made to providers owned/ managed by persons that are close family members of persons in the service of the state which is contravention of SCM Regulations.
58. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as supporting evidence could not be provided.

HR Management

59. The competencies of financial and supply chain management officials were not assessed promptly in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels regulation 13.
60. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Regulations on Minimum Competency Levels reg14(2)(a).

Waste management

61. The municipality's operational activities on its waste disposal site contravened or failed to comply with the requirements of a waste management license or permit and the norms and standards in terms of section 67(1)(f)&(h) of the National Environmental Management: Waste Act, 2008 (Act No. 59 of 2008) (NEMWA) and section 29(4) of the Environmental Conservation Act, 1989 (Act No. 73 of 1989).

Internal control

62. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

63. Management failed to timely appoint appropriately skilled staff in key positions within the finance unit. Policies and procedures did not adequately guide financial and performance activities. Action plans designed to address prior year audit findings were not implemented and reflects negatively on management's ability to address recurring audit findings. Effective leadership and oversight responsibility exercised regarding financial and performance reporting, compliance and related internal controls was inadequate since various material misstatements and non-compliance issues were identified.

Financial and performance management

64. Management failed to implement effective controls to ensure that information in the financial statements and the report on predetermined objectives were reliable before submission for

audit. This was mainly due to the inability of management to address the prior years' audit findings and staff in the finance section not understanding the requirements of the financial reporting framework.

Governance

65. Although the municipality had a functioning audit committee and internal audit, recommendations by internal audit and audit committee to address internal control deficiencies were not adequately implemented by the municipality.

André Gerard

Rustenburg

30 November 2012



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

